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FM AMEMBASSY SAN SALVADOR
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INFO RUEHZA/WHA CENTRAL AMERICAN COLLECTIVE
RUCPDOC/DEPT OF COMMERCE WASHINGTON DC
RUEATRS/DEPT OF TREASURY WASHINGTON DC
RHEHNSC/NSC WASHINGTON DC

C O N F I D E N T I A L SAN SALVADOR 001364

SIPDIS

E.O. 12958: DECL: 12/12/2028
TAGS: EFIN PGOV ECON ES
SUBJECT: GOES LIQUIDITY PROBLEMS, LOANS AND CREDIT LINES

REF: A. SAN SALVADOR 1353
¶B. SAN SALVADOR 1332
¶C. SAN SALVADOR 1238

Classified By: AMBASSADOR CHARLES L. GLAZER, REASONS 1.4(B,D)

¶1. (C) SUMMARY. El Salvador's fiscal and liquidity problems continue, despite Government of El Salvador (GOES) negotiations with various international financial institutions. The private banking sector remains liquid and prepared for massive post-electoral capital flight, though the threat of bank runs continues to be of concern and credit markets have tightened (reftel A). The GOES has also not yet resolved how to roll over its short-term debt, with $80 million needed on December 15 and at least $418 million needed before the end of the Saca Administration on June 1 (reftel B). Vice President de Escobar has also been seeking money from countries in the Middle East.

¶2. (C) The National Assembly is supposed to vote on a $500 million Inter-American Development Bank (IDB) loan package on December 10. While that money is earmarked for repaying 2011 debt and funding new social programs, it could free up other funds to cover Letters of Treasury ("Letes"). The Central Bank has negotiated a separate $500 million credit line from the IDB, though its terms of use remain unclear and it might be too costly to use. Likewise, the Central Bank is negotiating a contingency credit line with the International Monetary Fund, but political concerns over conditionality will likely prevent securing that line except in a crisis. An arrangement with the Central American Bank for Economic Integration (CABEI) might be the most attractive option for GOES, but there is no certainty that CABEI will have sufficient funds to meet Salvadoran and other regional demands. In the current financial storm, the country is looking to the government to restore confidence in the economy, which could prove to be a tough task. END SUMMARY.

LIQUIDITY PROBLEMS

¶3. (SBU) Salvadoran Private Banking Association (ABANSA) President Armando Arias, former Central Bank President Rafael Barraza, and Citibank Vice President Francisco Nunez all confirmed that the GOES rolled over its November Letters of Treasury ("Letes") using funds from various semi-autonomous institutions (e.g., the port authority, the water company). Removing the institutions' funds from the private banks did not, as Barraza had feared (reftel C), have a negative effect on the banking system. By reducing bank deposits, however, this maneuver also likely made the banks less likely to roll over Letes.

¶4. (SBU) On November 26, Ministry of Finance Director of Fiscal and Public Credit Policy Manuel Rosales said that the GOES would need $80 million in short-term financing by December 15, including rolling over $60 million in Letes and

issuing $20 million in new Letes to cover tax revenue short-falls (reftel B). According to Ministry of Finance figures, the GOES needs to roll over $93.4 million in Letes in January, $92.4 million in February, $131.5 million in March, $87.4 million in May, and $13.6 million in June. These figures do not include any new debt to make up for lost tax revenue. (COMMENT: The Ministry of Finance has shared its debt information only reluctantly, and what they have provided is often inconsistent or incomplete. END COMMENT)

¶5. (SBU) In addition, the GOES needs to reach an agreement by December 11 to reimburse electricity companies $66 million of the remaining $93.7 million in electricity subsidies from April-October 2008. The GOES has continued to insist publicly that it will receive this money from the Central American Bank for Economic Integration (CABEI), though no loan has been finalized and the Treasury Ministry's Rosales told Econoff that CABEI cut its assistance for Letes from $300 million to $150 million, all of which has already been allocated. According to electricity company representatives, the GOES will owe at least an additional $40 million in April 2009 for the electricity subsidies from October 2008-April
¶2009.

¶6. (U) According to November 30 and December 3 press reports, Vice President Ana Vilma de Escobar asked the governments of Qatar, Kuwait and Bahrain to buy Letes during bilateral sidebars at a United Nations conference in Qatar. CABEI Director for El Salvador Miguel Angel Siman was with VP de Escobar on the trip and confirmed the request to Econoff on December 8. He was unaware of any commitments from those governments to purchase Letes or other Salvadoran debt, but said they were sending the three Arab governments additional information.

¶7. (C) The GOES has established a liquidity commission, and according to former Finance Minister Hinds, President Saca took Hinds' suggestion to include former Central Bank President Barraza on the commission. Hinds had not, however, seen the commission actually do anything. When asked what the commission did, Central Bank President Luz Maria de Portillo replied only that "it meets every Tuesday." Arias expressed his frustration when he told Econoffs that ABANSA had not been consulted or asked to participate in the liquidity commission.

IDB-WB LOAN PACKAGES

¶8. (SBU) The Inter-American Development Bank (IDB) approved a $500 million loan on November 25, part of a $950 million package of IDB and World Bank loans. While the GOES had been given approval to negotiate the loan by unanimous vote in the National Assembly, the final loan must still go to the Assembly for ratification by a 2/3 majority. Ministry of Finance Director Manuel Rosales said that the GOES planned to present the loan to the Assembly on December 10. According to local IDB representative Carmenza McLean, the first tranche of $200 million should be available before the end of
¶2008. Central Bank President Portillo said the GOES does not expect action on the World Bank's $450 million loan until sometime in January 2009.

¶9. (C) To secure opposition support for the $950 million loan package, the GOES negotiated an agreement with the FMLN that $650 million ($200 from IDB, $450 from WB) would go to pay off El Salvador's 2011 Eurobond debt and $300 million (IDB) would be used to fund new social programs. Initial reports from the agreement were that the money for social spending would not be used until after the next government took office in June 2009. On November 26, however, Ministry of Finance Director Rosales said that the GOES would use the first tranche of $200 million on social spending.

¶10. (C) IDB Rep. McLean contradicted Rosales, telling EconCouns that the loan documents specifically provided for the first $200 million to go to 2011 Eurobond debt repayment. In addition, she lamented that the GOES had been slow to

provide needed information to the IDB and had not done much
to educate the National Assembly to assure passage of the
loan package by the needed super majority. McLean said the
Assembly had to approve the package on December 10 and haveit published in the official gazette on December 1, in order
to give the IDB time to process the lan before it closed its
books for the year on Deember 18. Though, she left open the
possibilitythat other arrangements could still be made to
diburse the first tranche of $200 million by year's nd, if
the deadline was missed by only a few day.

¶11. (C) Most of El Salvador's 2011 Eurobond dbt is held
domestically, primarily by the semi-autonomous institutions.
Banco Agricola Executive President/former Central Bank
President Roberto Orellana and former Finance Minister Hinds
have suggested that the GOES pre-pay some of its 2011
Eurobond debt, which would free funds that could be used to
buy Letes. Hinds said Central Bank President Portillo had
affirmed that the GOES could pay off the Eurobond early
without penalty, but when Hinds suggested this plan to
Minister of Finance William Handal, he told Hinds that they
"had to wait until they could get the best possible deal for
the government." When asked on several occasions whether
this idea was feasible, Ministry of Finance Director Rosales
replied "no" but could not articulate why. (NOTE. According
to the 2011 Eurobond offer, the Eurobonds are not callable,
but the GOES is permitted to buy and retire them on the open
market. The 2011 Eurobonds were recently trading at about 94%
of face value in the Salvadoran market. END NOTE.)

IDB Credit Line

¶12. (SBU) The Central Bank has also negotiated a $500 million
line from the IDB liquidity facility to be used for
short-term lending for "working capital" to the "productive
sector." (NOTE: This line is still pending final approval
from the IDB board. END NOTE.) Central Bank President
Portillo stated that the credit line was for 5 years (with a
3 year grace period) at LIBOR plus 4% (with an additional
1.75% in commissions and fees). Portillo added that the
Central Bank had not yet received guidance from the IDB on
how, exactly, the credit line may be used. The Central Bank
was likely, however, to channel the money through the
state-owned Multi-Sector Investment Bank (BMI), which has
"more experience" in this type of lending.

¶13. (SBU) Participation by the banking sector will be
optional, and ABANSA President Arias expressed doubt that
many banks would opt to participate. While the banks had not
received the final details, the terms they had heard so far
were so restrictive and would require so much documentation
that Arias thought it would not be worth the banks' time.
Citibank VP Francisco Nunez noted that, from Citi's point of
view, the credit line was "very expensive at LIBOR plus 500
to 600 basis points" and very limited in what areas it could
be used. For instance, both Nunez and Central Bank President
Portillo did not think the credit line could be used for
construction projects. Nunez also stated that the GOES did
not seem to understand the difference between liquidity risk
and credit risk, and was attributing the tightening of credit
markets entirely to liquidity risk. Nunez was unsure whether
most banks would actually use the credit line for lending, or
if they would treat it as a contingency credit line.
Citibank, he said, had enough liquidity to meet all of its
lending needs through December, but would reevaluate its
position in January in the event of election-related capital
flight.

¶14. (SBU) According to Central Bank President Portillo,
because the credit line would pass through the Central Bank
to the private sector, it did not need to go to the National
Assembly. This also meant, however, that those funds could
not be used to buy Letes or other government debt. On
December 2, FMLN presidential candidate Mauricio Funes stated
that, in his view, the Central Bank did not have the
authority to obtain this credit line without approval by the
National Assembly.

IMF Credit Line

¶15. (C) The Central Bank is also discussing with the International Monetary Fund (IMF) a contingency credit line of up to $1.2 billion, but Central Bank President Portillo said the GOES is still trying to decide what kind of IMF assistance would be most effective. In former Central Bank President Rafael Barraza's view, however, the decision is actually political. Barraza stated that El Salvador likely did not qualify for the IMF's short-term liquidity facility and had to look at other options which require more conditionality. Barraza said that the Saca Administration was unlikely to sign off on anything that required conditionality before the January and March 2009 elections, for fear of political backlash, but the GOES would likely complete negotiations to the point where something could be signed immediately. This would make the assistance available to address an emergency, but would not provide the same confidence boost to the banking sector.

CABEI Assistance

¶16. (SBU) According to CABEI Director for El Salvador Siman, CABEI has provided the Central Bank of El Salvador with a $200 million credit line, $195 million of which has already been disbursed. Siman said that CABEI had an additional $150 million contingency line to the Central Bank ready that the GOES could accept should negotiations with the IMF break down. In Siman's view, the Central Bank of El Salvador is the most solid in Central America.

¶17. (SBU) In order to purchase GOES Letes, CABEI had established a local trust (fideicomiso) and was inviting other investors, including the IDB, to participate. Siman stated that CABEI thought this was the "most transparent" way to buy Letes, and hoped that a CABEI-backed trust would boost confidence and attract other, new investors. When asked whether CABEI could provide more funds to buy Letes beyond the $150 million that it already provided, Siman replied that CABEI would consider any new request from the GOES, but it would have to be weighed against the numerous requests they were receiving from the other Central American countries. El Salvador currently ranks 4th out of the 5 member countries in terms of assistance received, with less than $900 million in total debt.

¶18. (SBU) Siman confirmed that the GOES and state-owned utility CEL had not secured a loan from CABEI to cover the outstanding electricity subsidy. CABEI and the GOES were in talks, and CABEI was reviewing CEL's latest financials, but a loan proposal had not gone to CABEI's directors and would not "before January at the earliest." While CABEI normally lends for infrastructure projects, Siman stated that they also do "working capital" loans, which could be used to pay subsidies. He added that, in the event CABEI did not approve a new loan to CEL, the GOES had the right to request part of the existing $140 million loan for the El Chapparal dam be diverted to "working capital." "CABEI is based in Central America, not Washington," he commented, "so we're pretty flexible about such things."

COMMENT

¶19. (C) El Salvador continues to face short-term liquidity problems and its fiscal accounts will continue to be vexed by subsidy expenses. The IDB and WB loans, if passed will provide some needed relief, but will not necessarily resolve either the liquidity or fiscal problems. In light of the urgent need for immediate funds to roll over Letes, Treasury Minister Handal's apparent reluctance to buy back 2011 Eurobonds from domestic bondholders who might then be able to purchase Letes does not make sense. Luminaries such as Hinds, Barraza, and former Minister of Economy Miguel Lacayo all continue to believe that the Ministry of Finance is a

major impediment to resolving the short-term debt problem. Minister of Finance Handal is viewed only the man who "holds the President's pocketbook," and none of the Ministry's staff are seen as strong figures. While Hinds remarked that he had seen some signs President Saca was becoming more concerned, Saca's two closest advisors, Herbert Saca and Elmer Charlaix, are the same advisors who pushed budget-busting subsidies in the first place. While there is a possibility that the Liquidity Commission could persuade President Saca otherwise, the early signs of that Commission's effectiveness are not promising.

¶20. (C) The international financial crisis and next year's elections are the two major factors affecting the Salvadoran economy and investment climate. Saca could do a great deal to restore confidence in the economy by coming up with a comprehensive plan on how to address debt and credit (reftel A) and presenting that plan to the public. Economists like Lacayo, Luis Membreno and Hinds are saying that people are looking to the GOES (with multilateral and other assistance) for signs that the country can not only weather but also stimulate the economy to emerge from the current financial storm.

¶21. (C) That strategy implies two things; that Saca is willing to face up to the issue, and he has a team in place that can develop and execute such a plan. However, the administration does not want to pursue any assistance (e.g., the IMF credit line) that requires conditionality, both for fear of how it could be played by the FMLN in the campaign, and because that conditionality would likely include reducing and targeting government subsidies for electricity, gas, water, and transportation. Given their reluctance to share information and questionable past economic policy choices we also question whether his current advisors are up to the task, even if they wanted to do it.
GLAZER